



**Testimony of Scott Stevenson  
President, Telecommunications Association of Michigan  
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**House Bill 4257**

Good morning Chairman Mayes and members of the committee. My name is Scott Stevenson and I am the president of the Telecommunications Association of Michigan (TAM). We represent 35 companies that provide telephone, broadband, video and other advanced services to customers across the state.

Joining me this morning are Robin Gleason from AT&T, Paul Pederson from TDS, Jay Brogan from Hiawatha Communications and Mike Holmes, an attorney with 30 years of experience in telecom law. We're here today to explain why the members of our organization support the substitute to HB 4257 and to give you a better understanding of the critical role our members play in Michigan's economy. After my opening remarks, I'll turn it over the panelists to tell you more about the services their companies offer and then we'll discuss the substitute in detail.

**Michigan Telecom Companies Deliver Advanced Services**

One of the most important facts to keep in mind when discussing the substitute to House Bill 4257 is that your constituents have access to basic and advanced telecom services thanks to the investments being made by Michigan's incumbent local telephone companies.

It was in 1877 when an Upper Peninsula businessman was so impressed by Alexander Graham Bell's new telephone that he decided to install a phone line between the Lake Superior port at Ontonagon and his inland office. Other local business owners soon wanted in on the new technology, and the Ontonagon County Telephone Company was born.

That same year, throughout the state, other telephone pioneers were stringing up their first lines, connecting farms, homes and businesses. So marked the beginning of a communications revolution that fundamentally changed the way people in Michigan and the world talk to each other and do business. In those early years, hundreds of telephone companies sprang up in Michigan to offer residents the new communications service. Today, many of those original telephone companies continue the tradition of providing service to everyone who wants it.

Of course, the services customers want today are far different than the voice calls that were so radical when first introduced 132 years ago. High speed Internet connections are the name of the game in the 21<sup>st</sup> Century. TAM members started deploying broadband connections more than a decade ago and haven't stopped investing since. When it became possible to deliver video programming over phone lines, Allendale Communications was the first company in Michigan to embrace the technology, quickly deploying the service so its customers had a choice when considering cable TV companies. AT&T's U-Verse service has been rolling out to hundreds of

communities across the state and many of our member companies are in or are entering the video business by investing in upgrades to their existing network infrastructure.

Even as incredible advances in technology have allowed new types of communications to flourish, millions of Michigan residents and businesses depend on the wires built by local telephone companies to deliver the highest quality, most reliable services available. Without these wires, and the investments that keep them working, people would discover that their cell phones can't connect to the doctor's office and that their broadband connections won't link to Michigan.gov.

The only way telecom companies can make such significant investments in Michigan is if they are able to recover their costs. As described below, telecom cost recovery has become very complicated from decades of regulatory changes but the fundamental goal has always been that customers in every big city and small village should have access to comparable services at comparable prices. The real power of a communications network is fully realized when it reaches everyone.

### **Access Charges Can't Be Viewed in a Vacuum**

HB 4257 changes the way Michigan regulates access charges. As you heard in previous testimony from the Michigan Public Service Commission (MPSC), access charges are part of a complicated, comprehensive system of intercarrier compensation that telecom companies rely on to keep prices affordable for customers. There are many components of the total system, some overseen by the Federal Communications Commission (FCC) and some by the MPSC. Each of those components is dependent on the other components. That means, for example, that interstate access charges are set at levels that reflect how much individual customers are required to pay in federal subscriber line charges. When one component is reduced, it generally causes an increase in other components.

Access charges are imposed by local telephone companies on other companies that send calls over their networks. The FCC created access charges after the 1984 break up of AT&T to ensure that long distance companies continued to pay for their use of local telephone networks. Access charges are designed to recover the costs of originating and terminating long distance calls on the local phone network. (Roughly speaking, interstate access charges cover costs associated with handling calls between states and intrastate access charges cover in-state costs.)

The FCC has taken action since 1997 to reduce the average interstate per-minute access charges that telecom companies paid to small, rural companies. The FCC recognized that local telephone companies would need to recover the revenues they would be losing from the savings being received by other telecom companies. So the FCC provided additional support from the federal universal service fund and it allowed local telephone companies to increase their subscriber line charges. Today, those charges can be as high as \$6.50 a month for residential customers and more than \$9.00 for business customers. In essence, the burden of supporting local telephone networks was shifted to local customers and away from large providers. If it weren't for Michigan's existing treatment of access charges, local prices would be forced even higher.

One easy way to understand the relationship between access charges and rural customer bills is to remember that when access charges are cut, rural telecom companies lose money and their customers pay more for service. While it is no surprise that some telecom companies would prefer to pay less, or nothing at all, when they use the networks of small, rural telephone companies, the resulting rate increase on customers would certainly come as an unwelcome surprise to customers when their bills come due.

### **Access Charges Vary Because Costs Vary**

Even though small company intrastate access charges were deregulated in 2000 (due to the Section 310 exemption) to avoid basic phone service price increases resulting from FCC reforms, TAM member rates have remained at very near the same levels they were nine years ago. Our small companies have not attempted to game the system or to impose higher than necessary costs on other providers. In fact, the intrastate access rates being charged by TAM member companies are based on cost studies that were reviewed and approved by the MPSC.

The reason small companies have higher access rates than large companies is that the cost of providing service is higher in rural areas. Companies operating in primarily rural areas face numerous differences from non-rural companies, including factors such as the scope of services offered, size, the geographic dispersion of customers and physical terrain. These unique circumstances often make rural carriers' cost of providing both standard voice service and advanced services much higher than non-rural providers.

For example, rural carriers serve only eight percent of the nation's access lines, but these service areas are spread out over 38 percent of the nation's land mass. Nationally, the population density in areas served by rural carriers is only about 13 people per square mile. This compares to a national average population density of 105 persons per square mile in areas served by non-rural carriers. In Michigan, the difference is 22 people per square mile in rural company territories and 211 people per square mile in non-rural markets. These differences lead to wide gulfs between the abilities of large and small carriers to achieve economies of scale and scope. (*Rural Task Force Report, attached.*)

Other characteristics that differentiate rural carriers from large carriers and make the provision of service more costly include:

- Higher local line costs due to longer lines and the remoteness of the areas that they serve.
- Higher unit costs for switching equipment due to smaller and more geographically dispersed subscriber populations that offer a limited volume of telephone traffic.
- Average income in rural service areas is twenty percent lower than in areas served by larger carriers.
- Higher proportion of residential versus business subscribers.

When taken together, these factors lead to significantly higher costs to provide service on a per customer (line) basis for small, rural companies than for large companies. A study conducted for the federal government shows that, on average, the total investment per "loop," or line, is more than \$5,000 for rural companies compared to less than \$3,000 for non-rural companies. The

actual difference can be much higher for individual companies. Access charges are designed as one way to apportion the costs of paying for services between the end user customers and the companies that use rural provider networks. (*Rural Task Force Report*)

### **Misconceptions About Interstate Access Rate Revenues**

Some non-rural providers perpetuate misconceptions about interstate access rate revenues in order to give the impression that Michigan's rural companies are already fully recovering their network costs. The truth is that most of Michigan's rural providers have costs in excess of what interstate access rates recover. They all participate in the FCC's very heavily regulated intercarrier compensation system, which, unfortunately, is as complicated to explain as it is to implement.

Many Michigan rural providers receive revenue in addition to what they bill the toll access purchaser (inter-exchange carrier or long distance company) per their interstate tariffed access rates. These rates were developed by the National Exchange Carrier Association (NECA) per FCC rules and regulations. The NECA filed interstate access rates only provide partial recovery of the cost to provide interstate access services.

Rural providers from across the country participate in NECA's tariff. The costs of providing interstate access service and the forecasted interstate access minutes for the participating providers are averaged to develop averaged interstate access rates, again per FCC rules and regulations. NECA files these tariffs at the FCC for approval.

For those rural companies participating in NECA's pool, they bill at their NECA tariffed interstate access rates. These ILEC then report their billed (and received) revenue to the appropriate NECA interstate access pool. These revenues are for interstate access services provided per NECA's tariff F.C.C. No. 5 to inter-exchange carriers for switched and dedicated access and the billed interstate Subscriber Line Charge (SLC). Additionally, individual companies report their costs, as defined by FCC rules and regulations, to NECA to determine monies NECA will reimburse those companies for interstate access services performed and billed under NECA's Tariff F.C.C. No. 5. NECA then reimburses these providers for their individual interstate access costs.

Since the NECA rates are a result of averaged costs and NECA's pools are funded by revenue not generated per tariff, the amount of reimbursement provider receives can be more or less than the interstate access revenue the ILEC reports and submits to NECA. For Michigan's rural companies participating in NECA's pools, their 2008 reported costs, for providing interstate access services, were greater than the interstate tariff revenues billed and collected. Therefore, these ILECs received reimbursement from NECA for costs in excess of the interstate access revenue billed per tariff they submitted.

Michigan rural provider interstate access rates do not recover their full interstate costs as defined by the FCC. The difference between what these ILEC charge and their costs is made up through the NECA pooling process and monies from the Universal Service Fund (which is billed outside of the filed tariff).

As interstate switched access rate reductions were implemented, the FCC provided for other revenue sources like Local Switching Support (LSS), and Interstate Common Line Support (ICLS) along with increases in the federal end-user SLC for residential and business.

LSS is designed to help carriers recoup some of the high fixed switching costs of providing service to fewer customers. LSS helps keep customer rates comparable to more densely populated urban areas. Prior to 1998, this support was known as Dial Equipment Minute, or DEM, weighting and was recovered from switched access charges. In 1998, DEM weighting was removed from local switching rates, established as LSS, and made a part of the High Cost Program. LSS is subject to an annual "true-up" process to adjust support amounts based on actual incumbent carrier data submitted no later than 15 months after the end of the calendar year for which historical data are submitted.

ICLS helps to offset interstate access charges and is designed to permit each rate-of-return carrier to recover its common line revenue requirement, while ensuring that its subscriber line charges remain affordable to its customers. ICLS is based on annual projected data submitted by incumbent carriers each March 31 and is subject to an annual true-up process based on actual data submitted by incumbent carriers each December 31 for the previous calendar year.

The Section 310 exemption accomplished the same policy goals in Michigan as LSS and ICLS accomplish at the federal level. The restructuring mechanism will continue to meet those goals while updating our regulations to be more closely aligned with federal regulations.

### **Carefully Balancing Customer Impacts and Industry Regulations**

As time passes, Michigan's regulatory policies continually drift away from changes being made to federal regulations. The MTA has been completely rewritten numerous times over the past 20 years to keep up with these changes. The issue before you today is focused only on a single section of the MTA. However, toll access charges are one of the most significant sources of revenues that companies use to keep prices affordable, provide advanced services, and keep Michigan workers on the payroll. In order to keep pace with changes to federal toll access policies, we support a revision of Section 310 that is carefully balanced to weigh many legitimate, though sometimes competing interests.

Our view of the substitute to HB 4257 is that it accomplishes the necessary balance. By creating a tightly focused mechanism for shifting the flow of access revenues between providers to a centralized administrator, the substitute creates certainty for providers and protects the interest of customers. It also continues the legislature's tradition of proactive policymaking by replacing an outdated section of the MTA with a section that is compatible with federal rules and regulations.

The substitute for HB 4257 is supported by our membership of large and small telephone companies, incumbent and competitive providers and wireless companies. These companies have one important trait in common: they all make substantial investments in Michigan communities to bring state of the art services to Michigan customers.

### **How the Substitute for HB 4257 Works**

The substitute for HB 4257 will close the gap between large and small provider *intrastate* access rates by restructuring the way small companies recover their network costs. This restructuring mechanism – which will act as an independently operated system – will require the participation of all providers but will limit reimbursements to only those providers that have traditionally been responsible for delivering telephone service to customers when no other providers are present. However, even providers eligible for reimbursements will face limitations on how much they can recover based on how their monthly prices compare to a statewide benchmark price.

The restructuring mechanism is a coordinated effort by the Michigan Public Service Commission (MPSC), a statutorily created Oversight Committee, and a neutral third party administrator. All telecom providers that connect to the public switched network will continue to pay for that access by participating in the restructuring mechanism.

The MPSC will calculate the total loss of revenues small providers will experience by lowering their *intrastate* rates to their corresponding *interstate* levels. It is anticipated that the total, statewide impact on small provider revenues will be approximately \$15-20 million.

The impact of losing those revenues without the restructuring mechanism would be devastating to small companies who serve just hundreds or thousands of customers spread out over large geographic areas. The restructuring mechanism makes sure customers served by small providers aren't hit with large increases in their monthly phone bills.

The next step is to calculate how much reimbursement eligible providers will forego based on the benchmark price. That amount will be subtracted from the total *intrastate* access revenue loss to arrive at the total restructuring mechanism amount. Finally, the third party administrator calculates a percentage of retail revenues every provider will be assessed to pay for network access in exchange for lower *intrastate* access charges.

All of the calculations and underlying support documentation will be submitted to the MPSC for review and approval. When the MPSC is satisfied the requirements of the compromise have been followed, it will issue an order restructuring the collection and disbursement of *intrastate* access charge revenues.

The process doesn't end there, though. If one thing is certain, it's that telecommunications technology and federal regulations will continue to evolve after Michigan's restructuring mechanism is created. HB 4257 recognizes this and requires the MPSC to resize the restructuring mechanism every three years. If changes are needed to protect customers, the compromise sets out a structure for making them. It moves Michigan's telecom policies in the right direction for customers and for the companies that provide jobs and investment in our communities.

There's no way to claim that the substitute for HB 4257 is a simple solution to a complex problem. It is a complex solution to a complex problem, but it's one that is carefully balanced to keep phone prices affordable, promote advancement in technology, protect Michigan jobs and

ensure fair competition. This is necessary to bring Michigan's regulations in line with past and pending changes to federal intercarrier compensation mechanisms.

### **What's At Risk Without the Substitute**

#### ***Price Increases for Hundreds of Thousands of Customers***

As I said earlier, the MTA's existing access charge exemption was created to solve two problems simultaneously. It stopped the revenue losses small companies were suffering due to federal access charge reductions that had to be "mirrored" on the state level and it avoided large price increases on Michigan customers.

If the MTA is amended to eliminate the exemption without establishing the restructuring mechanism, every provider losing its exemption will be under tremendous pressure to raise prices. Our estimates are that the customers of small companies will be looking at as much as \$13.00 increases in the cost of basic monthly phone service. None of our members want to be put in that position by the legislature, particularly given how many of their customers are already struggling to pay their bills.

Low-income customers would be especially hard hit if intrastate access charges were cut without the restructuring mechanism. These customers receive discounts off monthly phone service prices and installation charges through the Lifeline program, which is part of the federal universal service system. Should rural companies have to make up intrastate access revenue losses via price increases, Lifeline customers would see the value of their discounts diminished.

The substitute for HB 4257 avoids the need for price increases because it restructures part of the intercarrier compensation system instead of eliminating it.

#### ***Reliable Access to Emergency Services and Advanced Broadband Networks***

With the restructuring mechanism in place as proposed in the substitute to HB 4257, customers won't be facing double digit price increases for landline service. Some wireless companies may argue that you shouldn't worry about price increase because landline customers can simply switch to wireless service. As those of you who represent rural areas know, the reality of wireless coverage and service quality in many parts of Michigan make it an unreliable option, if it's an option at all.

Small telecom companies provide service in some of Michigan's most remote areas. The history of these companies is that they were founded by local residents because other providers refused to serve high-cost rural territories. That's still the case today on the landline side, and it's also true for wireless providers. Wireless companies do not offer service in many rural Michigan communities. And even in rural communities where wireless may be a substitute for standard voice service, it can't take the place for landline broadband service that small companies have deployed to virtually their entire customer bases. Wireless companies have a long way to go before their networks are capable of providing the high quality, high-speed networks that small landline providers offer in rural communities.

Some might argue that if rural customers can't switch to wireless to avoid large price increases, that's the price they pay for living in remote areas. Setting aside the fact that the intrastate access rates charged by small companies to large companies are intended to compensate the small companies for their investments, the "too bad" argument has some potentially serious drawbacks.

Most importantly, rural customers have the same right to access accurate and reliable 911 service that non-rural customers enjoy. Today, they have that with their landline phones. If they're forced to switch to a lower quality, less reliable product, they'll be stuck with 911 locating technology that is far inferior to landline capabilities. Worse yet, if they can't afford the wireless plans being offered in rural areas, they may not have access to 911 service at all. The restructuring mechanism in the substitute for HB 4257 makes sure companies investing in rural networks—companies that bring emergency and broadband services to customers—continue to be compensated when other companies use those networks.

### ***Jobs in Rural Michigan***

All of the members of TAM provide good paying jobs to Michigan workers. Whether it's the thousands of AT&T employees or the dozen employees of a small TAM member, these workers live and work in the communities they serve. Their tax dollars support state and local services and their support for community and charitable organizations enrich the quality of life for everyone. As Michigan struggles in a very tough economy, holding on to every job possible has to be a priority for you and your colleagues.

If the access revenues that small companies use to serve rural communities are eliminated without creating a restructuring mechanism, jobs will be at serious risk. Lacking sufficient revenues to maintain services and not wanting to impose sharp price increases on their customers, many small companies will look to cut back on personnel costs. With the restructuring mechanism in place, companies keep paying each other when using each other's networks and workers hold on to their jobs.

### **What Others Have Said About Access Restructuring**

The MPSC has looked at the issue of intrastate access rate revenues in the past. Some of the same companies who are likely to take positions on the substitute to HB 4257 are on record with positions that help to support our arguments.

In a 2004 MPSC docket to determine if intrastate access rates should be lowered, Verizon said:

"For example, if a 'flash-cut' to the new 'mirrored' rates places a financial burden on small LECs, should such significant policy change be implemented without the establishment of a transitional (or permanent) funding mechanism to replace the revenue reductions caused by the policy change? If not, how will the fund be sized? Who should pay into the fund? How should contributors assess fees to their end users, and how should the funds be distributed? Even if the Commission had authority to set the access rates of



small LECs, it would create a host of complex issues.” (*MPSC Case No. U-14175, Verizon Reply Comments, October 1, 2004*)

We agree with Verizon that lowering intrastate access rates raises “host of complex issues.” Though the restructuring mechanism proposed in the substitute to HB 4257 may not give Verizon or any other provider exactly what it wants, it tackles complex issues in a comprehensive way.

In the same docket, SBC (now AT&T) confirmed its belief that access charges play a critical role in telecom network investments, stating:

“Access reductions imposed upon local carriers deprive them of revenue needed to fund investment in their Michigan networks. That investment generates taxes, jobs, and economic benefits to communities and the State as a whole. It is an unwise policy that damages the State's current attempts to improve its economic well-being. Furthermore, IXCs and other carriers have little or no incentive to construct their own facilities and networks and to invest in infrastructure if they get use of other carriers' networks at bargain basement rates.” (*MPSC Case No. U-14175, SBC Comments, September 17, 2004*)

TAM members wholeheartedly endorse this statement and it is a prime reason we support the substitute bill. The proposed restructuring mechanism does not deprive carriers of needed revenues, it shifts payments from a decentralized system to a centralized one.

The former AT&T and Sprint filed joint comments in this docket disagreeing with many of the arguments put forth by SBC and Verizon as to how intrastate access rates should be set for non-rural companies. When discussing rural providers, however, AT&T acknowledged that they are in a much different position than the large, non-rural companies.

“It is important to recognize, however, that while principles of regulatory parity might be applied to similarly situated carriers serving similarly situated end-users, this does not mean that the Commission should be blind to the fact that all carriers (and, more importantly, all end users) are not similarly situated. Rural carriers clearly require a different approach....” (*MPSC Case No. U-14175, AT&T Reply Comments, October 1, 2004*)

Again, we find ourselves agreeing with AT&T and Sprint—rural companies are not similarly situated to non-rural providers. The comprehensive restructuring mechanism created in the substitute to HB 4257 recognizes those differences.

### **Conclusion**

Michigan was one of the first state’s to allow competition in its telecommunications marketplace and has maintained that leadership position by keeping its policies predictable and understandable for all providers. At the same time, the legislature’s determination to make sure that prices remain affordable for customers in all parts of the state has been beneficial to the state’s residents and businesses.

The substitute for HB 4257 recognizes that a portion of our law is diverging too much from federal law as federal regulations change and significant revisions loom on the horizon. It will update Section 310 of the MTA with a new version that fits Michigan's specific needs.

When enacted, the substitute for HB 4257 will take the best provisions of other state and federal policies regarding access charges and create a restructuring mechanism that provides clarity and certainty for the whole industry. Companies operating in Michigan as competitors will know how much they'll pay for network access and Michigan's network owners will know their investments can be recovered. This allows competition to move forward on a level playing field with clearly defined rules.

Perhaps most importantly, the substitute for HB 4257 avoids pushing rural telecom companies into a position of needing to raise prices, cut investments or lay off employees. It is a carefully crafted comprehensive proposal that balances the desires of a diverse telecom industry with the needs of their customers. We encourage you to support the substitute bill for all of these reasons.